

87-SBE-034

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JOHN E. JOHNS, D.D.S., INC.,) No. 86A-1308-SW
TAXPAYER, AND JOHN E. JOHNS.)
ASSUMER AND/OR TRANSFEREE)

For Appellant: David L. Thompson
Enrolled Agent

Pot Respondent: Kathleen M. Morris
Counsel

OPINION

256661/ This appeal is made pursuant to section 256661 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John E. Johns, D.D.S., Inc., Taxpayer, and John E. Johns, Assumer and/or Transferee, against a proposed assessment of additional franchise tax and penalty in the total amount of \$8,888, for the income year ended January 31, 1985.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

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and John E. Johns, Assumer and/or Transferee

The issue presented in this appeal is whether accounts receivable can be included as income in a corporation's final taxable period when the corporation was a cash basis taxpayer.

John E. Johns, D.D.S., Inc., was a California service corporation engaged in the practice of dentistry. On May 8, 1984, the corporation adopted a plan of liquidation under section 24512 and Internal Revenue Code section 337. All of the assets, including \$100,810.79 in accounts receivable, were distributed to the sole shareholder, John E. Johns, D.D.S. The corporation, in its final franchise tax return filed two months after its due date, did not report the \$100,810.79 as gross income. The corporation used the cash method of accounting and takes the position that because it did not receive the income from the accounts receivable, it did not have to report the amount as income on its final return.

Respondent determined that the accounts receivable represented income to the corporation. It issued a proposed deficiency notice including a 10-percent delinquent filing penalty against the corporation and against John E. Johns as the transferee/assumer. Appellants have protested the proposed assessment, but have raised no argument regarding the delinquency penalty.

Section 24651, subdivision (b), provides that if the method of accounting used by a taxpayer does not clearly reflect income, the Franchise Tax Board may use a method that does clearly reflect such income. This section is substantively identical to section 446(b) of the Internal Revenue Code of 1954. Accordingly, federal case law is highly persuasive in interpreting the California statute. (*Rihn v. Franchise Tax Board*, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

As a general rule, taxable income is computed under the accounting method regularly used by a taxpayer. However, if a corporate taxpayer's method of accounting, due to a dissolution, does not clearly reflect the income, that method does not have to be accepted by the taxing agency. (*Jud Plumbing & Heating, Inc. v. Commissioner*, 153 F.2d 681 (5th Cir. 1946).) We must conclude that appellant corporation's accounting method did not accurately reflect its income.

In the case of *Williamson v. United States*, 292 F.2d 524 (Ct.Cl. 1961), a corporation, engaged in the

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business of **servicing** oil and gas wells, liquidated and distributed all its assets, including its accounts receivable, to its sole shareholder. The corporation kept its books on the cash receipts and disbursements method of accounting and reported its income accordingly. The accounts receivable constituted amounts **due** the corporation, but not paid, for services **rendered by** the corporation in full performance of **various** well-servicing contracts prior to the date of distribution. On its final income tax return none **of** the accounts receivable was reported **as** income. The Williamson court held that the liquidation of the corporation prior to the actual collection of the accounts receivable will not prevent the income from being realized by and taxed to the corporation when the corporation had earned the money and had fully perfected its right to receive the money prior to liquidation. The court **emphasized** the fact that the corporation had a fixed right to the future income on the date of its dissolution and that when income has been fully earned it must be realized and taxable to the entity that earned it regardless of the accounting method involved. (Williamson v. United States, supra, 292 F.2d at 530.) This case is indistinguishable from the facts in the present case. Appellant corporation had **performed** the dental services **prior** to its liquidation and had done everything necessary to perfect its right to the income, Like the money in the Williamson case, the accounts receivable was due **and owing** the corporation on the date of dissolution. When the corporation paid the dividend to John E. Johns on liquidation, it had the enjoyment of its income and must recognize this amount. (See Gorton v. Commissioner, ¶ 85,045 T.C.M. (P-H) (1985); Standard Paving Co., et al. v. Commissioner, 190 F.2d 330 (10th Cir. 1951).)

For the reasons discussed above, **the** action taken by respondent concerning the deficiency and the penalty must be sustained.

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and John E. Johns, Assumer and/or Transferee

O R D E R

Pursuant to the views expressed in the opinion
of the board on-file in this proceeding, and good cause
appear inq therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED,
pursuant **to** section 25667 of the Revenue and **Taxation**
Code, that the action of the Franchise Tax Board on the
protest of John E. Johns, D.D.S., Inc., Taxpayer, and
John E. Johns, Assumer and/or Transferee, **against** a
proposed assessment of additional franchise **tax** and
penalty in the total amount of \$8,888 for the income year
ended January 31, 1985, be and the same is hereby
sustained.

Done at **Sacramento, California**, this 7th **day**
of **May**, 1987 by the **State Board** of Equalization,
with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett,
Mr. Carpenter and Ms. Baker present.

<u>Conway H. Collis</u>	, Chairman
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Paul Carpenter</u>	, Member
<u>Anne Baker*</u>	, Member

*For Gray Davis, per Government Code section 7.9